Cap-Wise Fund Strategy: Tailoring Flexi, Mid, and Small-Cap Holdings for the Wealthy - An Analytical Assessment of Portfolio Efficiency

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Abstract

As investors accumulate wealth, their portfolios often become increasingly crowded with multiple mutual fund schemes under the assumption that more funds will provide superior diversification. Yet, holding a large number of flexi-cap, mid-cap and small-cap funds may not deliver the benefits that investors expect. This paper examines long-term rolling-return patterns and volatility behaviour to understand how portfolio efficiency is influenced as more schemes are added to the same category. The analysis shows that while the first few funds contribute meaningfully to performance, each additional fund gradually dilutes the influence of high-quality performers. Similarly, volatility does not consistently decrease with the inclusion of more schemes, resulting in weaker risk-adjusted outcomes. The findings suggest that the real value of diversification comes from selecting funds with distinct styles and complementary exposures rather than accumulating a large number of similar schemes.

Keywords

Mutual funds; Diversification; Portfolio design; Rolling returns; Volatility; Flexi-cap funds; Mid-cap funds; Small-cap funds.

Introduction

As investors progress financially, they often feel compelled to expand their portfolios. The logic appears simple: more funds should translate to broader diversification and reduced portfolio risk. This tendency is especially noticeable among high-net-worth investors who build large positions across flexi-cap, mid-cap and small-cap mutual funds. However, diversification has its limits. After a point, adding new schemes may do little more than replicate existing holdings, while simultaneously diluting the impact of the strongest performers.

The Misconception of 'More Is Better' in Diversification

Many investors assume that expanding the number of funds creates a safety net. What often goes unnoticed is the substantial overlap in holdings across schemes within the same category. When a new fund largely mirrors the holdings of existing ones, the portfolio may appear diversified on the surface but behaves almost identically during market movements.

When Additional Funds Begin to Hurt Performance

Data from long-term rolling returns reveal a consistent pattern: the first one or two funds typically provide the bulk of the value. As more schemes are added, the overall return gradually slides downward because the allocation becomes thinner across performers of varying quality.

Table 1. Effect of Incremental Fund Addition on Average Five-Year Rolling Returns (2013–2025)

Number of Funds	Flexi-Cap (%)	Mid-Cap (%)	Small-Cap (%)
1	21.6	20.7	24.5
3	19.8	20.5	23.3
6	18.4	19.9	22.0
9	17.6	19.6	21.0
12	17.1	19.3	20.1

Note. Based on average daily rolling returns from January 2013 to November 2025.

Table 2. Impact of Incremental Fund Addition on Portfolio Volatility and Risk-Adjusted Returns (2013–2025)

Number of Funds	Least-Volatile (SD/RA)	Average-Volatile (SD/RA)	Most-Volatile (SD/RA)
3	12.9 / 1.6	15.5 / 1.2	18.0 / 1.5
6	13.3 / 1.2	15.3 / 1.3	17.1 / 1.3
9	13.6 / 1.4	15.4 / 1.2	16.8 / 1.4
12	13.8 / 1.4	15.5 / 1.2	16.7 / 1.0

Note. SD = standard deviation; RA = risk-adjusted return.

Conclusion

Owning a long list of mutual funds does not necessarily lead to better diversification or stronger performance. As the analysis shows, excessive diversification dilutes the strength of high-quality funds and rarely provides meaningful risk reduction. True diversification arises from selecting funds that complement each other—not from increasing their quantity.

References

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